In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 535

UNITED STATES OF AMERICA, PETITIONER

v.

JOHN CATTO, JR., AND ROXANA CATTO

UNITED STATES OF AMERICA, PETITIONER

v.

W. H. WARDLAW, INDEPENDENT EXECUTOR OF THE ESTATE OF C. W. WARDLAW, DECEASED, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

1. Respondents argue that the Fifth Circuit's decisions in the instant cases do not conflict with the decisions of the Eighth and Ninth Circuits. They state that the Fifth Circuit has held the instant Treasury Regulation invalid only as to taxpayers who chose the unit-livestock method before 1944—the earliest date (according to respondents) that cattle raisers could have known they were entitled to capital gain—while the Eighth and Ninth Circuits upheld the Reg-

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ulation only in cases involving taxpayers who had a post-1944 choice.

The facts of the present cases refute that contention. The respondents in the instant *Catto* case could have changed their method of accounting in 1948 or 1951, well after a "meaningful option" was available. (See *Wardlaw* Br. in Opp. 20; *Catto,* R. 39, fn. 1.) The respondents in *Wardlaw,* on the other hand, could not have changed their method of accounting after 1944. Nevertheless, the Fifth Circuit stated that the questions presented by *Catto* and *Wardlaw* were "identical" (Pet. 18, fn. 1). The court clearly recognized that its position was in conflict with that of the Eighth and Ninth Circuits (Pet. 20, fn. 4).

It is clear that the Fifth Circuit rested its decisions in the instant cases on the dichotomy between cash and accrual basis ranchers and not, as respondents contend, upon whether a rancher had a choice of accounting methods after 1944.[1]

[1] The principal reason the government opposed certiorari in *United States* v. *Ekberg*, 291 F. 2d 913 (C.A. 8), certiorari denied, 368 U.S. 920, was because at that time the Fifth Circuit's position was in doubt. (See Pet. 5–6.) The instant cases, of course, remove any such doubt.

The government's *Ekberg* brief in opposition also distinguished the Fifth Circuit's *Lewis* holding on the ground that the taxpayers in *Lewis* had no choice of accounting methods after 1944 while the taxpayers in *Ekberg* did. This statement was meant only to demonstrate that no clear conflict existed, since there was no assurance that the Fifth Circuit would have reached a result contrary to the Eighth Circuit on the basis of the facts presented in *Ekberg*. (The instant decisions, of course, now demonstrate that it would have.) The government does not, however, believe that the Regulations here in question are invalid as to any taxpayer, including one who had no opportunity to change accounting methods after 1944.

2. Respondents urge that the Treasury Regulation here in question is invalid because it requires them to include raised breeding animals, on which they are entitled to capital gain, in inventory. As we pointed out in our petition and as respondents admit in their briefs, the sole purpose of this provision in the Regulations is to require accrual method ranchers to capitalize the costs of raising breeding animals so that at the time they are sold the excess of the sales proceeds over accumulated raising costs will constitute capital gain. (See, *e.g.*, Pet. 8–10; *Wardlaw* Br. in Opp. 13, 14, fn. 16.)

Because it is virtually impossible to determine exactly which of a rancher's expenses are attributable to raising his breeding animals, this result is accomplished by a two-step procedure: (1) The taxpayer deducts all of his expenses; (2) the taxpayer then adds to income an estimate of the costs of raising his breeding animals. This has the effect of reducing his deductible expenses by the amount of the costs attributable to raising the breeding animals. This portion of his expenses (which is not currently deductible) is then added to the animals' cost basis.

This procedure does not, by any stretch of the imagination, violate the purpose of § 1231, which entitles ranchers to capital gain treatment on the "gains" from sales of breeding animals. The word "gain" is, of course, defined elsewhere in the Code as the excess of the sales proceeds over the accumulated cost or other basis of the property sold. 1954 Code §§ 1001, 1011–1013. Thus by requiring accrual method ranchers to accumulate the costs

of raising breeding animals, the Regulations do not conflict with § 1231; they merely treat accrual method ranchers the same as taxpayers in other businesses.

Respectfully submitted.

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